

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF IDAHO

IN RE)	
)	Case No. 99-41514
DONALD HEPWORTH and)	
SUSAN HEPWORTH,)	SUMMARY ORDER
)	
Debtors.)	
_____)	

Background.

Creditors Ray and Juanita Hepworth ("Creditors") filed a Motion for Approval of an Administrative Expense Claim (Docket No. 34) pursuant to Sections 503(a), 503(b)(1)(A), and 507(a) of the Bankruptcy Code. Debtors Donald and Susan Hepworth ("Debtors"), as well as Chapter 7 Trustee R. Sam Hopkins ("Trustee"), object. A hearing on the motion was held on April 20, 2000, after which this matter was taken under advisement.

Facts.

The facts are undisputed. On September 8, 1999, Debtors filed for

bankruptcy relief under Chapter 12 of the Bankruptcy Code.¹ Immediately prior to filing their voluntary petition, however, Debtors obtained a loan from Creditors, who are Donald Hepworth's parents. As a result of this transaction, Creditors advanced \$12,400 to Debtors to enable Debtors to retain their bankruptcy attorney.² A check in that amount was given by Creditors to Donald Hepworth on September 7, 1999, one day prior to Debtors filing their petition. The check was deposited in Debtors' bank the following day, September 8, the same day the petition was filed. The check was paid by Creditors' bank on September 9. At issue is whether this loan constitutes an administrative expense entitled to priority of payment in this bankruptcy case pursuant to Sections 503(a), 503(b)(1)(A), and 507(b).

Disposition.

¹ Debtors were unable to present a confirmable Chapter 12 plan, and on March 7, 2000, the case was, at Debtors' request, converted to Chapter 7 pursuant to Section 1208(b).

² Creditors' motion requested approval of an administrative expense claim in the total amount of \$32,330. Included in this sum were amounts paid by Creditors for certain farm operating and insurance expenses in addition to the \$12,400 advanced for Debtors' attorney's fees. At the motion hearing, Creditors' counsel represented that a stipulation had been reached with Trustee regarding \$9,931.13 of those expenses, all of which had been advanced postpetition in the ordinary course of Debtors' business, and therefore, according to the parties' agreement, entitled to administrative expense priority status. Other than the \$12,400 loan at issue here, Creditors have abandoned their efforts to obtain approval of any additional administrative expense claim.

The Bankruptcy Code allows a first priority status for administrative claims. 11 U.S.C. § 507(a)(1).³ Whether a claim should be treated as an administrative expense is determined under Section 503. Subsections (a) and (b)(1)(A) provide:

(a) An entity may timely file a request for payment of an administrative expense

(b) After notice a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including –

(1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case;

11 U.S.C. §§ 503(a), (b)(1)(A).

To establish entitlement to an administrative expense priority, the claimant must demonstrate that its claim: “(1) arose from a transaction with the debtor-in-possession as opposed to the preceding entity (or, alternatively, that the claimant gave consideration to the debtor-in-possession); and (2) directly and substantially benefitted the estate.” *Microsoft Corp. v. DAK Industries, Inc. (In re DAK Industries, Inc.)*, 66 F.3d 1091, 1094 (9th Cir. 1995). The burden of proving

³ While administrative expenses are generally granted equal status for payment in a bankruptcy case, administrative expenses incurred in a Chapter 12 case that was later converted to a Chapter 7 case are eligible for payment only after all Chapter 7 administrative expenses have been paid in full. 11 U.S.C. § 726(b).

this entitlement is on the claimant. *Id.* Moreover, “administrative expenses under Section 503 are construed narrowly because they give one unsecured creditor absolute priority in payment over other unsecured creditors and over the estate.” *Id.* at n. 3.

By definition, Donald and Susan Hepworth were not “debtors,” nor could they occupy the status of debtors-in-possession, until their Chapter 12 case was commenced upon the filing of their bankruptcy petition on September 8, 1999, at 2:23 p.m. See 11 U.S.C. § 101(13) (“debtor” means a person concerning which a case under Title 11 has been commenced); 11 U.S.C. § 301 (bankruptcy case is commenced upon the filing of the petition); 11 U.S.C. § 1203 (debtors in Chapter 12, unless removed, occupy status of debtors-in-possession). The credit transaction whereby Creditors loaned Debtors \$12,400 to hire counsel took place on September 7, the day before any bankruptcy estate was created. This loan is evidenced by the check written and delivered by Creditors to Donald Hepworth on September 7. Because the loan was extended to Donald and Susan Hepworth prior to becoming debtors-in-possession, Creditors’ claim arose prepetition.

Creditors argue that it is the date the check was processed by the Debtors’ bank, and not the date the check was written, which is relevant for

purposes of determining whether the expense was incurred before or after the filing of the bankruptcy petition. In other contexts, Creditors would be correct. For example, the date a check is honored is critical in determining whether a payment from a debtor to a creditor constitutes an avoidable prepetition preference under Section 547(b). *Barnhill v. Johnson*, 503 U.S. 393, 394-95 (1992). However, the focus of the analysis should be different under Section 503(b)(1)(A), given its underlying purpose.

Creditors are granted administrative expense priority to encourage them to extend credit or otherwise deal with an entity already in bankruptcy. *In re Molnar Bros.*, 200 B.R. 555, 559 (D. N.J. 1996); *In re Allen Care Centers, Inc.*, 163 B.R. 180 (Bankr. D. Or. 1994). This purpose is not served if the relevant date of inquiry was the date the check was honored or processed by the Creditors' bank. While the parties have cited, and the Court has located, no reported cases regarding this exact issue, given the policy underlying Section 503(b)(1)(A), the Court concludes the date the transaction occurs as between the parties, rather than some later date, such as the date the check is processed by the bank, should establish the bright line for determining whether an expense arose pre- or postpetition. Here, as between Creditors and Debtors, the loan transaction was consummated on September 7, one day prior to the filing of the

petition. This analysis is appropriate in light of the stated goals of the parties: Creditors were loaning Debtors the money to hire attorneys and to file and prosecute a bankruptcy case.

If the date the check was deposited and processed by Debtors' bank is the crucial one for determining Creditors' entitlement to administrative expense priority, Creditors have not shown that such occurred after the bankruptcy petition was filed on the afternoon of September 8. Courts from other jurisdictions have found that even hours or minutes are important in determining whether a debt was incurred pre- or postpetition. See *Vanco Trading Inc. v. Monheit*, 1999 WL 464531 (D. Conn. 1999) (fractionalization of date is permissible when determining whether expense is entitled to administrative priority; when shipment was delivered prior to moment of filing, it was not entitled to priority); *Bojalad & Co. v. Holiday Meat Packing Inc. (In re Holiday Meat Packing, Inc.)* 30 B.R. 737 (Bankr. W.D. Pa. 1983) (administrative expense priority denied because shipment was delivered two and one half hours prior to filing of petition). Because there has been no factual showing as to the actual timing of the processing of the check as compared to the filing of the bankruptcy petition on September 8, Creditors' argument fails on this matter as well.

Because the Creditors' loan of the \$12,400 to Debtors occurred

before the bankruptcy case was commenced, Creditors' claim is not entitled to administrative expense priority. Creditors' claim must be treated as a non-priority unsecured claim. The Court need not address the other issues raised concerning the motion.⁴

For the foregoing reasons, Creditors' Motion for Approval of Administrative Expense Claim, as it relates to the \$12,400 loan, must be **DENIED.**⁵

IT IS SO ORDERED.

DATED This _____ day of May, 2000.

JIM D. PAPPAS

⁴ Although incurring a debt to retain counsel in a Chapter 12 case would most likely "directly and substantially benefit the estate," because the loan to obtain such services was extended prepetition, the Court makes no finding whether in this case the second element required by the Code and case law for administrative expense status has been satisfied. Additionally, the Court need not analyze whether, under Section 364(a), this transaction was entered into by Debtors in the ordinary course of their business, thereby giving Creditors administrative expense status. And while it is of course speculation, had the parties merely waited until the bankruptcy case had been commenced and applied to the Court for approval to incur this unsecured debt under Section 364(b), the Court strongly suspects on this record the transaction would have been approved.

⁵ The parties should submit a separate order to reflect any stipulation concerning allowance and disallowance of Creditors' other claims for administrative expense status.

CHIEF U.S. BANKRUPTCY JUDGE

CERTIFICATE OF MAILING

I, the undersigned, hereby certify that I mailed a true copy of the document to which this certificate is attached, to the following named person(s) at the following address(es), on the date shown below:

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CASE NO.: 99-41514

CAMERON S. BURKE, CLERK
U.S. BANKRUPTCY COURT

DATED:

By _____
Deputy Clerk